

**FEDERAL COMMUNICATIONS COMMISSION
Enforcement Bureau
Market Disputes Resolution Division
445 12th St., S.W.
Washington, D.C. 20554**

October 16, 2002

Copies by Facsimile Transmission; Originals by U.S. Mail

TOUCH AMERICA, INC.,

Complainant,

v.

QWEST COMMUNICATIONS
INTERNATIONAL INC,
QWEST CORPORATION, and
QWEST COMMUNICATIONS
CORPORATION,

Defendants.

File No. EB-02-MD-003

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America")

Counsel for Defendants (collectively
"Qwest")

Dear Counsel:

After reviewing the parties' briefs in this matter, we have concluded that Qwest should be required to produce additional discovery directed to specific topics addressed in the parties' briefs, filed on August 2, 2002 and August 16, 2002. This additional discovery is discussed below.

An excerpt from Qwest's Form 10K Annual Report for 2001 that was attached to Touch America's August 2, 2002 brief ("Annual Report")¹ indicates that Qwest accounts for its sales of optical capacity, which are typically structured as indefeasible rights of use ("IRUs"), as either "sales-type leases" or as "operating leases."² The Annual Report further indicates that Qwest recognizes revenues from sales of optical capacity that meet the criteria of a sales-type lease at the time the capacity is delivered to and accepted by the customer.³ The Annual Report states that Qwest treats IRUs as sales-type leases for accounting purposes so long as:

(1) Qwest receives sufficient consideration; (2) (x) Qwest has passed substantially all risks and rewards of ownership to the fiber or capacity, including responsibility for operation and maintenance cost and risk of technological or economic obsolescence, to the customer, (y) Qwest does not have substantial continuing involvement with the capacity sold, and (z) ownership has passed or will pass by the end of the agreement; and (3) the customer receives a specific fiber or channel on the Qwest network that only the customer can utilize.⁴

The Annual Report also states that "Qwest will not enter into [operating] leases involving routes with an end-point in a state in Qwest's local service area until Qwest has obtained permission to offer interLATA services in that state."⁵

Touch America's August 2, 2002 brief also attached a press release from Qwest dated July 28, 2002 ("Press Release")⁶ stating that Qwest had concluded that its revenue recognition policies "were incorrectly applied to optical capacity asset transactions in 1999, 2000 and 2001 which totaled approximately \$1.16 billion in recognized revenue . . .⁷ The Press Release also states that Qwest is analyzing the application of its accounting policies to all of Qwest's optical capacity sales transactions, as well as the appropriateness of the policies themselves, and advises that Qwest may conclude that it recognized revenue inappropriately with respect to these transactions."⁸

In view of the statements set forth in the above-referenced documents, we conclude that information regarding the accounting treatment of the IRU transactions that

¹ Brief of Touch America, Inc. File No. EB-02-MD-003 (filed Aug. 2, 2002) ("Touch America Brief") at Appendix 2, Attachment B, "United States Securities and Exchange Commission Form 10-K Annual Report for the Fiscal Year Ended December 31, 2001 for Qwest Communications International" ("Annual Report Excerpt").

² Annual Report Excerpt at 72-73.

³ *Id.* at 73.

⁴ *Id.*

⁵ *Id.*

⁶ Touch America Brief at Appendix 2, Attachment A, press release entitled, "Qwest Communications Provides Current Status Of Ongoing Analysis Of Its Accounting Policies And Practices," dated July 28, 2002, ("Press Release").

⁷ Press Release at 1. The press release treats the terms "optical capacity asset" and "IRU" as synonymous. *Id.*

⁸ *Id.* at 2.

are the subject of Touch America's Complaint in this action is relevant to our analysis of the merits of the parties' respective claims and defenses in this case.⁹ Accordingly, pursuant to Rule 1.729(h),¹⁰ we hereby order Qwest to produce to Touch America, and file with the Commission:

(1) A sworn statement that identifies, for each of the IRU agreements that Qwest has produced in this action (a) whether Qwest accounts for the IRU transaction memorialized in the agreement as a sales-type lease or as an operating lease; and (b) whether Qwest has changed or plans to change such accounting treatment, and if so, the reason for such change. The sworn statement should comply with all the requirements for interrogatory answers set forth in Rule 1.729(e).¹¹

(2) All documents in Qwest's possession, custody or control that discuss: (a) the accounting treatment of any of the IRU transactions referenced in paragraph (1) above as sales-type leases or operating leases; or (b) Qwest's decision not to enter into operating leases involving routes with an end-point in a state in Qwest's local service area until Qwest has obtained permission to offer interLATA services in that state, and/or the reasons for that decision.

Qwest shall produce and file the discovery set forth in paragraphs (1) and (2) above by no later than 20 calendar days from the date of this order. In the event that Qwest seeks to withhold any responsive information on the grounds that it is protected by the attorney-client privilege or work product doctrine, Qwest should prepare a supplement to its previously filed privileged document log covering the information withheld, and file and serve the supplement by no later than 20 days from the date of this order.

This letter ruling is issued pursuant to sections 4(i), 4(j), and 208 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), and 208, and sections 1.720-1.736 of the Commission's rules, 47 C.F.R. §§ 1.720-1.736, and authority delegated by sections 0.111 and 0.311 of the Commission's rules, 47 C.F.R. §§ 0.111, 0.311.

⁹ Both sides in this case have cited the other side's accounting treatment of IRUs as evidence relevant to the merits of this case. *See, e.g.*, Qwest's Brief on Legal Permissibility of Qwest's IRUs, File No. EB-02-MD-003 (filed Aug. 2, 2002) at 4 & n.5; Reply Brief On Legal Permissibility Of Qwest IRUs, File No. EB-02-MD-003 (filed Aug. 16, 2002) at 35-36 & n.44; Touch America Brief at 11, 20-22.

¹⁰ 47 C.F.R. § 1.729(h).

¹¹ 47 C.F.R. § 1.729(e).

FEDERAL COMMUNICATIONS COMMISSION

A handwritten signature in black ink, appearing to read "Lisa J. Saks", written in a cursive style.

Lisa J. Saks, Esq.
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